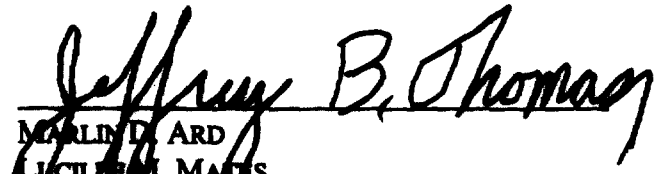


VIII. Conclusion

For the reasons given, we urge the Commission to reject the anticompetitive reading of the 1996 Act propounded by carriers who object to full and fair competition by the BOCs in interLATA markets. Congress intended competition to be vigorous; Congress intended regulation to be the minimum necessary; Congress intended that the BOCs would fully participate in interLATA markets. All we ask is that the Commission respect what Congress has asked it to do.

PACIFIC TELESIS GROUP


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Date: August 30, 1996

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Re: BOC Provision of "Carrier's Carrier" InterLATA Services

The Telecommunications Act of 1996 (the Act) allows a Bell Operating Company (BOC) to provide interLATA services to other carriers, including to the separate affiliate required by §272. The provision of such "carrier's carrier" services is subject to Commission approval under §271, if they originate in-region, and to the nondiscrimination safeguards of §272(e)(4), but not to the §272 separate affiliate requirement.

I. The Language of the Act Allows a BOC To Provide Carrier's Carrier Services

It is unquestioned that a BOC may provide out-of-region interLATA services both on a retail basis and to other carriers without Commission approval and without a §272 separate affiliate.¹ It is also clear that a BOC must have approval under §271, and use a §272 separate affiliate, to provide retail in-region interLATA services to the general public. The parties to CC Docket No. 96-149 disagree on whether a BOC must use a separate affiliate to provide in-region interLATA services to other carriers, including the BOC's own separate interLATA affiliate. The comments in that docket have focused on §272(e)(4). In addition to that subsection, it is also necessary to refer to the definitions in the Act and the specific provisions of §§271(b)(1) and 272(a)(2) to resolve this question. (See the attached diagram for an overview of the relationship between the §271 approval requirements and the §§272/274 structural separation requirements.)

Section 271(b)(1) of the Act requires Commission approval before a BOC may provide "interLATA services originating in any of its in-region States." Section 3(21) defines "interLATA services" as "telecommunications between a point located in a local access and transport area and a point located outside such area." Section 3(43) defines "telecommunications" as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." These provisions do not draw distinction between retail and carrier's carrier offerings. Thus, a BOC must obtain Commission approval

¹ The Commission's interim *Competitive Carrier* policy allows a BOC the option of using an affiliate that complies with certain safeguards (although not all of the §272 restrictions) or being subject to dominant regulation. Report and Order, Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, CC Docket No. 96-21, FCC 96-288 (released July 1, 1996).

under §271 before it may provide in-region interLATA services originating in-region to other carriers.²

Section 272 uses different terminology, with a different result.

Section 272(a)(2)(B) requires a BOC to use a separate affiliate for “[o]riginat[i]on of interLATA telecommunications services.”³ Section 3(46) defines “telecommunications service” to mean “the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.” Accordingly, the scope of the separate affiliate requirement only includes offerings “directly to the public.” This is a much narrower class of services than those described in §271(b)(1). Congress’s use of a different defined term in §272 (“telecommunications service” versus “interLATA service”) leaves no doubt that the BOC itself may provide carrier’s carrier services, which the BOC does not offer “directly to the public,” without using a separate affiliate.

In view of the above, there is a clear resolution to the controversy in Docket 96-149 over the meaning of §272(e)(4). That section states that a BOC “may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such service or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated.” Because the §272 separate affiliate requirement does not apply to carrier’s carrier offerings, there is no conflict between the requirement that retail services be offered through a separate affiliate. The function of §272(e)(4) in the Act, which is fully in harmony with §272(a),⁴ is to clarify expressly that (1) a BOC may provide carrier’s carrier services, (2) a BOC may provide facilities, as well as services, to carriers, (3) a BOC may make these offerings to its own interLATA affiliate, and (4) nondiscrimination and cost allocation apply to such offerings. Thus, §272(e)(4) is neither redundant nor is it in conflict with the overall structure of the Act.

II. BOC Provision of Carrier’s Carrier Services Is in the Public Interest

Section 271(d)(3)(C) requires a BOC to satisfy the Commission that the offering of carrier’s carrier services originating in-region will be consistent with the public interest before the BOC can offer such services. The BOC will make a specific public interest showing in a §271 application proceeding. However, several general public interest

² Section 271 only applies where a BOC “provides” interLATA services such as to another carrier or to the general public.

³ There are exceptions to this requirement not relevant to this discussion.

⁴ Even if §272(a) could somehow be read to include carrier’s carrier services, §272(e)(4) would constitute an exception because, as a matter of statutory construction, the more specific provision (§272(e)(4)) would take precedence over the general provision (§272(a)). *See MacEvoy v. United States*, 322 U.S. 102, 107 (1944). The Commission must avoid an interpretation of the Act that would make §272(e)(4) superfluous and must construe the Act to give effect to all of the words used by Congress. *See Beisler v. Commissioner*, 814 F. 2d 1304, 1307 (9th Cir. 1987).

considerations show that there is a sound policy basis for Congress's decision to allow BOC in-region interLATA carrier's carrier services.

A Bell regional holding company needs maximum flexibility to implement its network—the same flexibility that other providers of intraLATA and interLATA services enjoy—if it is to provide consumers efficient, economical, and innovative service. This includes the option of provisioning both intraLATA and interLATA services from the same underlying BOC network. Compared to using services provided by the BOC on a wholesale basis, the separate interLATA affiliate that provides retail services may not find it efficient to resell another carrier's services, acquire facilities from a third party, or construct new facilities. To optimize consumer welfare, the separate affiliate must be able to choose among all these options.

If the separate affiliate must buy from a competing interexchange carrier to provision its own interexchange services, its cost may be higher and it will be handicapped in competing on price with the existing interexchange oligopoly.⁵ The ability of the BOC to offer carrier's carrier services can add an additional source of facilities-based competition at the interexchange wholesale level that will serve not only the BOC's interLATA affiliate but potentially other second tier retail interexchange carriers, who are now subject to the pricing of the big three—AT&T, MCI, and Sprint.

In addition, the BOC may provide underlying services to its own interLATA affiliate for new retail offerings not now available in the marketplace. Consumers will benefit from the introduction of these new offerings and, because the BOC must make the same underlying services available to all carriers, other retail carriers will have an opportunity to match the BOC affiliate's products.

Finally, the §272 separate affiliate requirement may apply for as few as three years after the separate interLATA affiliate enters the market.⁶ Congress intended that this provision would sunset and that afterwards a BOC would be able to take advantage of all possible economies of scope and scale, just as all other carriers may do today. A BOC's provision of carrier's carrier services to its separate affiliate would permit a quicker and more efficient transition from structural separation to integration, which promises further cost reduction and consumer pricing benefits. Forcing the interLATA affiliate to acquire duplicative facilities would prove wasteful and inefficient.

⁵ Interexchange carriers are not legally obliged to provide at cost unbundled network elements to other carriers, nor to resell their services at wholesale prices—unlike the reverse situation where incumbent interexchange carriers are guaranteed an efficient method of entering the local market. Moreover, the major facilities-based interexchange carriers are nondominant and untariffed, which gives them total control over their offerings to retail carriers. Thus, the BOC's separate affiliate may or may not be able to negotiate favorable resale terms to provision its interLATA offering. Also, as long as the option of using BOC-provided facilities and services exists (even if not exercised), it will be a factor in negotiations for resale services from the interexchange carriers that will help the affiliate reach a price that is fair.

⁶ See §272(f)(1).

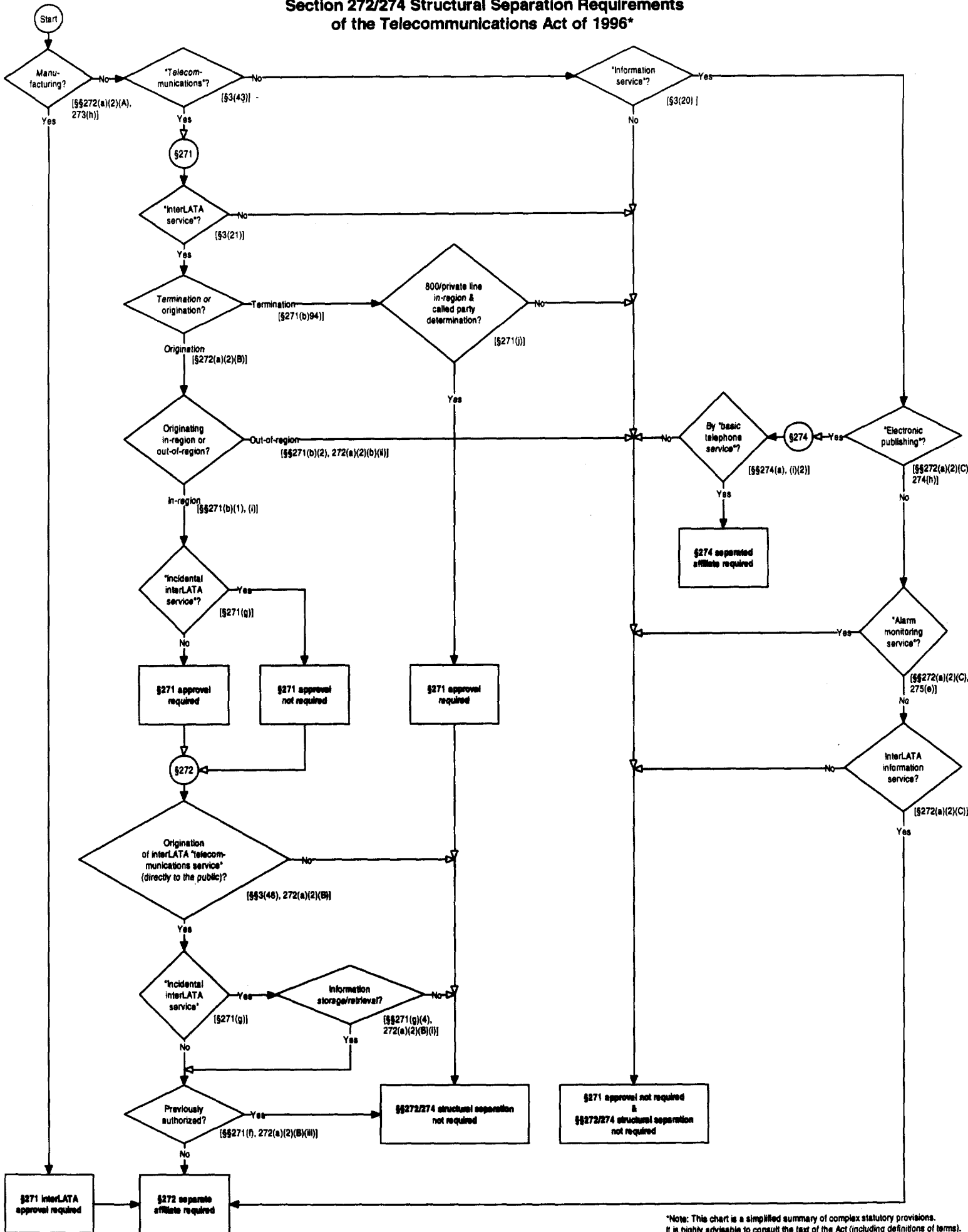
BOC provision of carrier's carrier services presents no risk of discrimination or cross-subsidy. In the first place, §271(d)(3)(B) requires the BOC to demonstrate to the Commission, before it may provide carrier's carrier services, that it will comply with §272, including the nondiscrimination provisions of §§272(c)(1) and 272(e)(4) and the accounting and affiliate transaction requirements of §272(c)(2). Second, the BOC will have an ongoing obligation under §§272(c)(1) and 272(e)(4) to offer such services on nondiscriminatory terms to all carriers. Third, the BOC will not directly engage in competition with other interLATA carriers for retail business, which is the largest and most critical part of the market. Instead, it would be acting as a supplier to interexchange carriers—sophisticated customers with many choices other than the BOC for interLATA service and facilities. These carriers can easily detect any discrimination—and easily avoid it by use of some other carrier's wholesale services.

The Commission's accounting and affiliate transaction rules, which implement §§272(c)(2) and 272(e)(4), will prevent the BOC from cross subsidizing any carrier's carrier services it provides to its interLATA affiliate. Moreover the BOC would have no incentive to set its prices at "subsidized" low rates, because the affiliate's competitors in the interexchange market would be entitled to the same prices and the BOC's affiliate would have no advantage. For the same reason, there would be no effect on competition at the retail consumer level because all carriers would have the same access to BOC services at the same prices.

* * *

In sum, the Act allows a BOC to provide in-region interLATA carrier's carrier services to its separate interLATA affiliate and to other carriers; the public will benefit from such offerings; and there is no danger of discrimination or cross subsidy.

**Section 271 Approval Requirements and
Section 272/274 Structural Separation Requirements
of the Telecommunications Act of 1996***



*Note: This chart is a simplified summary of complex statutory provisions. It is highly advisable to consult the text of the Act (including definitions of terms).

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PACIFIC  **TELESIS.**
Group - Washington

December 10, 1996

EX PARTE

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Mr. Caton:

Re: Non-Accounting Safeguards, CC Docket No. 96-149

We are submitting the attached material in response to questions from the staff. Please associate it with the above-referenced dockets. We are submitting two copies of this notice, in accordance with Section 1.206(a)(1) of the Commission's rules.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions.

Sincerely yours,



Gina Harrison

cc: Regina Keeney
A. Richard Metzger
Radhika Karmarkar
Cheryl Leanza

Attachments

EX PARTE RE. OCS FACILITIES RE. 96-149

This responds to two questions asked by the FCC Staff about Pacific Bell's potential use of its official company services network, PBNet, to provide interLATA transport services to its interLATA affiliate, PBCOM.

- Q1) Does PBNet currently have capacity to provide interLATA transport to its interLATA affiliate, PBCOM?
- A1) As explained in the attached declaration of Ross K. Ireland, Vice President, Network Engineering, PBNet does not currently have available capacity to provide interLATA transport services to PBCOM.
- Q2) Will current ratepayers be subsidizing PBCOM's entry into the interLATA business if PBNet is used to provide interLATA transport?
- A2) No. As noted above and in the attached Declaration, PBNet cannot currently be used to provide interLATA transport to PBCOM or any other interLATA service provider. PBNet would need substantial capacity to be used as a wholesale interLATA channel. The current price cap rules prohibit infrastructure costs from receiving exogenous treatment. Since our price caps cannot be increased for these costs, our rates cannot be increased nor will any investment needed to provide the connectivity and capacity to enable interLATA service over PBNet affect interstate access rates. Furthermore, since it became available, we have always chosen the "no sharing" option, so our interstate price caps cannot even be indirectly influenced by additional investment to support interLATA service. Therefore, Pacific Telesis' stockholders -- not its interstate access ratepayers -- will support Pacific Bell's provision of interLATA transport service.

Indeed, additional use of the network will result in economies of scope the Commission has in the past promoted. If the Commission adopts its tentative conclusion (CC Docket No. 94-1) to use a total factor productivity (TFP) method to set the interstate productivity factor (X-factor), when the X-factor is updated, any economies of scope will be automatically captured in that X-factor and lead to lower rates.

Moreover, under the Act, if Pacific Bell provides wholesale interLATA services to PBCOM, it must also provide wholesale interLATA services on nondiscriminatory terms and conditions to other IXCs. The current affiliate

transactions rules require Pacific Bell to publicly disclose the terms under which it provides services to PBCOM.

Lastly, Pacific Bell will follow the Commission's affiliate transaction rules which prescribe specific valuations for transactions among affiliates (including PBCOM). If Pacific Bell decides to offer interLATA transport services, under current regulations it will likely need to file tariffs to show that its proposed interLATA charges cover all related costs. In that case, Pacific Bell will charge PBCOM tariffed rates.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended;)	CC Docket No. 96-149
)	
and)	
)	
Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area)	
)	

Declaration of Ross Ireland

1. My name is Ross K. Ireland. My Title is Vice President, Network Engineering, Pacific Bell. My address is 2600 Camino Ramon, Room 2S001, San Ramon, California. My responsibilities are to provide statewide engineering and planning of Pacific Bell's switched and private line network. My responsibilities also include systems engineering, technical support and methods and procedures for engineering.

2. Pacific Bell's intracompany business communications (OCS) network, commonly referred to as PBNet, currently has no excess capacity. PBNet is Pacific Bell's existing intraLATA and interLATA interoffice transport network and is being used for its own intra-company business communications. These facilities provide intra-company local and long distance telephone service, video links for company

broadcasts and teleconferencing, remote access to and interconnection of company computer systems, and carry traffic related to provision of certain services, operations support systems and network management. Presently, Pacific Bell is sizing PBNet based on existing guidelines. Because of technology obsolescence and capacity drivers, Pacific Bell has been considering the conversion of the existing network from an asynchronous transmission technology to one using SONET technology. This would include builds to provide physical diversity as well as upgrading to SONET ring electronics. Any additional capacity currently envisioned will be for foreseeable OCS demand only. Capacity, in this context, means all facilities, fiber and electronics required to provide service.

3. If PB Comm or any other retail interLATA service provider were to request Pacific Bell to provide wholesale interLATA transport in California, Pacific Bell could not use PBNet as presently constructed and planned. The capacity required to provide the requested service would have to be added to PBNet. It does not exist today.

I declare under the penalty of perjury under the laws of California that the foregoing is true and correct.

Signed this 9th day of December, 1996 at San Francisco, California.


Ross K. Ireland

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December 6, 1996

Christopher J. Wright, Esquire
Deputy General Counsel
Federal Communications Commission
1919 M Street, N.W.
Washington DC 20554

Re: Section 271(e)(1) of the 1996 Act—CC Docket No. 96-149

Dear Chris:

This responds to the questions raised in our meeting with you on behalf of Pacific Telesis Group on December 4, 1996 regarding implementation of section 271(e)(1) of the Telecommunications Act of 1996.

Section 271(e)(1)¹ states that large interexchange carriers (e.g., AT&T, MCI, and Sprint) may not "jointly market" a BOC's telephone exchange service obtained at wholesale rates under §251(c)(4) with its interLATA services. Section 272(g)(2)² provides that a BOC may not "market or sell" its affiliate's interLATA services until such company receives interLATA authority under §271(d).

¹ Section 271(e)(1) provides:

Joint marketing of local and long distance services—Until a Bell operating company is authorized pursuant to subsection(d) of this section to provide interLATA services in an in-region State, or until 36 months have passed since February 8, 1996, whichever is earlier, a telecommunications carrier that serves greater than 5 percent of the Nation's presubscribed access lines may not jointly market in such State telephone exchange service obtained from such company pursuant to section 251(c)(4) of this title with interLATA services offered by that telecommunications carrier.

² Section 272(g)(2) provides:

Bell operating company sales of affiliate services—A Bell operating company may not market or sell interLATA service provided by an affiliate required by this section within any of its in-region States until such company is authorized to provide interLATA services in such State under section 271(d) of this title.

As the Commission has said, these sections "appear to be parallel provisions that are intended to prevent BOCs and the largest interexchange carriers from marketing local and long distance services jointly prior to the BOCs' entry into in-region interLATA service, if the interexchange carrier is purchasing incumbent LEC services pursuant to section 251(c)(4) for resale."³

1. As an initial matter, we believe that advertising *per se* is a form of marketing as intended by the Act and that any attempt to categorically exclude advertising from "joint marketing" would fly in the face of clear Congressional intent.

- The plain and ordinary meaning of the words compels the conclusion that advertising of joint services is included in the joint marketing prohibition
 - Advertising is a form—indeed, the primary and most pervasive form—of marketing a service. The dictionary definition reveals that "marketing" is "the process or technique of *promoting*, selling, and distributing a product or service."⁴ Advertising is simply one means of promotion—through public announcements aimed at increasing sales.
 - While we do not dispute that an IXC may separately market and sell interexchange services and resold local services—in separate advertisements, through separate marketing and sales channels, and with separate personnel—this does not override the prohibition on "joint marketing," i.e., marketing those services together on a combined basis. This includes combined advertising as well as any other combined marketing activities.
- The Commission in other contexts has found advertising to be part of joint marketing and has prohibited certain advertising.
 - As we discussed, Section 274(c) of the Act also refers to "joint marketing."⁵ While it is true that Congress in Section 274(c)(1) enumerated both "marketing" and "advertising," the importance of Section 274(c) for present purposes is that Congress clearly described "advertising" as a constituent part of "joint marketing." Indeed, the Commission has said that in section 274(c)

³ NPRM, Docket 96-149, ¶91.

⁴ Merriam-Webster Collegiate Dictionary, 10th Ed. (emphasis added).

⁵ Section 274 (c)(1) provides:

Joint Marketing.—(1) In general.—Except as provided in paragraph (2)—(A) a Bell operating company shall not carry out any promotion, marketing, sales, or advertising for or in conjunction with a separated affiliate; and (B) a Bell operating company shall not carry out any promotion, marketing, sales, or advertising for or in conjunction with an affiliate that is related to the provision of electronic publishing.

“‘joint marketing’ appears to contemplate the ‘promotion, marketing, sales, or advertising’ by a BOC for or with an affiliate.”⁶

- Moreover, the Commission’s Computer II rules include advertising within the ambit of marketing activities. Section 64.702(d)(1) of the rules provides that certain carriers “[s]hall not engage in the sale or promotion of enhanced services or customer-premises equipment, on behalf of the separate corporation,” and the Commission has consistently interpreted this rule to prohibit certain joint advertising activities: “entities affiliated with the subsidiary may not engage in advertising that is product or service specific on behalf of the subsidiary.”⁷
- The Commission also regulates the marketing of a variety of radiofrequency devices. In fact, Subpart I of Part 2 of the Rules relates to “Marketing of Radiofrequency Devices,” and Section 2.803 specifies that “no person shall sell or lease, or offer for sale or lease (including advertising for sale or lease)” certain devices.⁸

2. The record supports including advertising within joint marketing.

- Virtually all commenters either specifically agreed that advertising was included or assumed that it was included.
- For example, AT&T said that “‘marketing’ ... encompasses efforts by a firm to persuade a potential customer to purchase or subscribe to its services.”⁹
- Only MCI argued that the term “jointly market” does not include advertising. However, even this argument was not based on statutory or definitional grounds. Instead, MCI asserts that advertising is not the “type of joint marketing” prohibited by Section 271(e)(1) because IXCs are permitted to provide both types of services through one entity.¹⁰ From this premise, MCI reaches the unjustified conclusion that the same IXC employees and operations may market and sell both types of services, and that it would be more costly to duplicate advertising materials. In fact, MCI has put the cart before the horse. Because Congress did

⁶ NPRM, Docket 96-152, ¶53.

⁷ Computer Inquiry II, Reconsideration of Final Decision in Docket No. 20828, FCC 80-628 (Dec. 30, 1980). See also *American Information Technologies Corp.* 98 F.C.C. 2d 943, n.15 (1984) (“the unregulated subsidiary must do its own marketing, including all advertising relating to the offering of any service or equipment it offers”).

⁸ 47 C.F.R. §2.803.

⁹ AT&T Comments at 54.

¹⁰ MCI Comments at 46 (Aug. 15, 1996).

intend to prohibit all joint marketing until the BOCs have an opportunity to enter the interLATA market with similar joint marketing tools at their disposal, it necessarily follows that the same IXC employees and operations may not market and sell both types of services jointly.

3. Given the unambiguous meaning of the words, there is no room for a savings construction under *Ashwander*.¹¹

- In the most recent statement of the *Ashwander* principle, the Supreme Court said that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems *unless such construction is plainly contrary to the intent of Congress*." *DeBartolo Corp. v. Florida Gulf Coast Trades Council*, 485 U.S. 568, 575 (1988)(emphasis added). As indicated above, a categorical exclusion of advertising would fly in the face of the plain meaning of the words and the intent of Congress.
- Likewise, the Commission would not be entitled to *Chevron* deference where the statute is so clear. "That statutory interpretation by the board would normally be entitled to deference unless that construction were clearly contrary to the intent of Congress."¹²

4. Even if the FCC had the authority to rule on acts of Congress, the inclusion of advertising within the meaning of joint marketing is constitutional.

- The First Amendment does not apply to the joint advertising of interexchange and local service because the conduct of joint marketing of those services is unlawful until the conditions of §271(e)(1) are met.
- Because the underlying activities are unlawful, messages about those activities are not protected. For this reason, the regulation of advertising in this context is no more constitutionally suspect than other areas where the FCC regulates advertising.
- The First Amendment does not protect messages about *unlawful* activities. "[T]he government may ban commercial speech ... related to illegal activity." *Central Hudson Gas & Elec. v. Public Serv. Comm'n*, 447 U.S. 557, 563-64 (1980).

¹¹ *Ashwander v. TVA*, 297 U.S. 288 (1936).

¹² *DeBartolo*, 485 U.S. at 574 quoting *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843, and n. 9 (1984).

- Under the threshold criterion of *Central Hudson*'s four-part analysis, commercial speech "must concern lawful activity and not be misleading"¹³ to be protected by the First Amendment.
- As in *Pittsburgh Press*, where the Court upheld a restriction on discriminatory employment advertising, advertising of an unlawful transaction is not protected by the First Amendment. *Pittsburgh Press Co. v. Human Relations Comm'n*, 413 U.S. 376, 388 (1973).
- Similarly, the advertising of lottery information illegal in some states may be prohibited. *United States v. Edge Broadcasting Co.*, 509 U.S. 418 (1993).

5. You raised the question of whether rules can be developed that would address the restrictions on advertising in section 271(e)(1) without impermissibly restricting lawful speech. We believe that such regulations are reasonable, consistent with the intent of Congress, lawful, and can be crafted. In fact, attached are proposed rules that would implement section 271(e)(1) in a constitutionally permissible manner that would be faithful to Congress' clear intent to prohibit joint marketing until the BOCs have an opportunity to enter the interLATA market.

- Regulations, like the ones proposed, which restrict advertising of the availability of interLATA services combined with telephone exchange services obtained from a Bell operating Company pursuant to section 251(c)(4) of the Telecommunications Act of 1996 prevent "joint" marketing, but would not prevent separate marketing of any lawful services.

¹³ *Central Hudson*, 447 U.S. at 566. If the remaining parts of the *Central Hudson* test were to be considered, section 271(e)(1)'s limitations on advertising would satisfy them. First, the government has a substantial interest in promoting fair competition in the local and interexchange markets. Second, the regulation directly advances the governmental interest by assuring that interexchange carriers will not be able to jointly advertise interexchange services and resold BOC local exchange services until the BOC has had a fair opportunity to engage in competitive joint marketing. Finally, the restriction is not more extensive than necessary to serve the governmental interest. The restriction applies to only to the largest interexchange carriers. These carriers have both the best ability to develop and jointly market services without using resold BOC services. They also have the greatest market power to compete unfairly if allowed to "jump the gun" by advertising and selling jointly services that the BOCs cannot yet provide on any basis. The large interexchange carriers are free to jointly market interexchange services and local services provided over their own facilities, which would advance the Act's goal of promoting facilities-based local competition. In *44 Liquormart, Inc. v. Rhode Island*, 116 S. Ct. 1495 (1996), a majority of the Supreme Court emphasized the continuing validity of *Central Hudson*. As indicated in the opinion of Justice O'Connor, the Court may be expected to apply strictly the fourth prong of *Central Hudson*,—that there be a reasonable fit between the law's goal and its method. See 116 S. Ct. at 1521. Where Congress' goal is to restrict the joint marketing of interexchange and resold local exchange services, it is eminently reasonable to restrict advertising as a part of such joint marketing and no other reasonable and less restrictive means is available to prevent such joint marketing. This situation is quite unlike *44 Liquormart*, where the legislature was seeking to curb consumption of alcohol indirectly by suppressing price advertising.

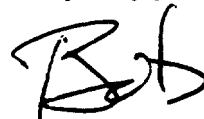
Christopher J. Wright, Esquire
December 6, 1996
Page 6

- A requirement that interexchange carriers use separate marketing and sales channels with separate personnel to advertise, promote, sell, or otherwise market telephone exchange service obtained from a Bell operating company pursuant to section 251(c)(4) of the Telecommunications Act of 1996 would implement Congress' intent without restricting any lawful marketing activities.
- A requirement limiting joint advertisements of lawful services to appropriate media would be consistent with a constitutionally permissible goal of banning misleading advertisements.
- In any event, the Supreme court recognized in *Edge Broadcasting* that restrictions on commercial speech, if they otherwise satisfy the *Central Hudson* test, may incidentally prevent some lawful advertisements.

Finally, as we discussed, I am enclosing a copy of the AT&T solicitation that promises "\$15 toward your local phone bill after three months, as long as you stay a customer of AT&T."

Thanks, again, for meeting with us to discuss these critical issues. We would be happy to discuss them further with you. In the meantime, if you have any questions or would like something further, please let me know.

Very truly yours,



Robert L. Pettit
Counsel for Pacific Telesis Group

cc: Chairman Hundt
Commissioner Quello
Commissioner Chong
Commissioner Ness
John Nakahata
Lauren J. Belvin
Jane Mago
James L. Casserly
William E. Kennard
Marjorie S. Bertman
Debra A. Weiner

Regina Keeney
A. Richard Metzger, Jr.
Carol Matthey
Radhika Karmarkar
Linda Kinney
William F. Caton (for inclusion in the
record in CC Docket No. 96-149)

Proposed Rule To Implement Section 271(e)(1)

§__ . ____ Joint Marketing of Local and Long Distance Services

- (a) Until a Bell operating company is authorized pursuant to subsection(d) of section 271 of the Telecommunications Act of 1996 to provide interLATA services in an in-region State, or until February 8, 1999, whichever is earlier, a telecommunications carrier that serves greater than 5 percent of the Nation's presubscribed access lines may not jointly market in such State telephone exchange service obtained from such company pursuant to section 251(c)(4) of the Telecommunications Act of 1996 with interLATA services offered by that telecommunications carrier.
- (b) A telecommunications carrier restricted by subsection (a) may not: (1) advertise the availability of its interLATA services combined with telephone exchange services obtained from a Bell operating Company pursuant to section 251(c)(4) of the Telecommunications Act of 1996; (2) advertise or provide a single point of contact (including a single telephone number) to market or sell both services; (3) identify both services specifically in a single advertisement; (4) make both services available from a single source (including an agent of such carrier); (5) transfer customers live or online from the marketing contact for one service to a marketing contact for the other service; (6) provide bundling discounts for the purchase of both services; (7) offer one service conditioned on the purchase of the other; (8) offer both services as a single combined service; or (9) make joint marketing presentations relating to both services.
- (c) A telecommunications carrier restricted by subsection (a) must use a separate marketing and sales channel with separate personnel to advertise, promote, sell, or otherwise market telephone exchange service obtained from a Bell operating company pursuant to section 251(c)(4) of the Telecommunications Act of 1996. Such separate marketing channel shall not engage in the sale or promotion of interLATA services offered by that telecommunications carrier.
- (d) A telecommunications carrier restricted by subsection (a) may not advertise the availability of its interLATA services combined with telephone exchange services through media or channels that may reasonably be expected to reach a substantial number of customers to whom such carrier cannot provide local exchange service except by telephone exchange services obtained from a Bell operating Company pursuant to section 251(c)(4) of the Telecommunications Act of 1996.



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Chatsworth, CA 91311-2390

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Sandra Raffirashed
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Novato, CA 94947-2872

|||||

Dear Sandra Raffirashed:

Very soon, AT&T will be the only phone company you'll need for every call you make. Because in the near future, we'll be able to bring you local service, too.

Meanwhile, we'd like to show our appreciation to you for being a valued AT&T customer. We have two exciting offers that can save you money and help pay for your local phone bill until we can provide local service to you.

Save 50% on your weekend calls.

Sign up for AT&T True Reach InternationalSM Savings, and you'll save 50% on all your direct-dialed international calls on weekends for six months.* That's right, 50% off AT&T True Reach International Basic Plan rates every Saturday and Sunday.

On top of that, you'll be saving up to 25% every day of the week on all your other types of calls—direct-dialed, operator-assisted and long distance cellular calls, plus calls using your AT&T Calling Card, fax machine and modem. And there's more.

We'll give you \$15 to help pay your local phone bill.

We'll send you \$15 toward your local phone bill after three months, as long as you stay an AT&T customer. It's almost like getting free local phone service until you can choose AT&T local service, which we look forward to bringing you in the next few months. Then you'll be able to enjoy the same AT&T quality, reliability and service on local calls that you're already getting on long distance.

Watch for exciting news to come about our new AT&T local phone service as soon as it becomes available in your area. Until then, please call us at 1 800 822-6154, Ext. 382, by September 30, 1996, to take advantage of our special offers.

Sincerely,

Stephen M. Jacobson
Marketing Vice President
Pacific Region

P.S. When you call, remember also to ask if you're getting all of the savings opportunities AT&T has for your calls around California and across the country.

* \$3.00 monthly fee applies. AT&T basic residential rates for domestic calls apply whenever you spend less than \$10 per month. When you spend \$10-\$24.99 per month your domestic discount is 10%. Qualifying calls and calls eligible for discount do not include conference calls and AT&T Calling Card calls that are not billed to a customer's main billed account. 900 # services, calls billed to a local exchange company calling card, nation calls, GTE Airfone and Railfone calls and taxes. Cellular long distance discount is provided in the form of a credit on your phone bill and is subject to additional conditions and exclusions. You must be a residential subscriber to AT&T to receive these discounts.
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Policy for BOC Joint Marketing of InterLATA Services and Provision of Shared Administrative Services

Legal requirements

Section 272 requires that Bell Operating Companies ("BOCs") provide in-region interLATA services through a separate affiliate and allows, under certain conditions, the BOC and the interLATA affiliate to market or sell each others' services. In addition, section 272 implicitly permits the holding company (or a services affiliate) to provide administrative services to both the BOC and the interLATA affiliate.¹ This section establishes detailed safeguards which are more than sufficient to prevent discrimination and cross-subsidy of competitive interLATA services by the BOC in connection with joint marketing or shared administrative services.²

Section 251(g) continues in effect the equal access obligation imposed under the MFJ.

Section 222, relating to the confidentiality of customer proprietary information (CPNI), also will affect joint marketing activities. It requires customer approval for a carrier to use CPNI obtained from one service, e.g., local, to market or sell another service, e.g., long distance.

Authorized activities

In order to enter the interLATA market efficiently and on an equal footing with other competitors, it is essential that the BOC have the ability to offer "one-stop shopping" and integrated packaging ("bundling") of local and interLATA services. This is expressly authorized by the Act: section 272(g)(2) allows a BOC to market or sell an affiliate's interLATA services once it is authorized under section 271. Similarly, the Act contemplates that the interLATA affiliate may also offer one-stop shopping by providing local service as a competitive local exchange carrier (CLEC) with its own facilities or those obtained from the BOC under section 251. Accordingly, section 272(g)(1) allows the interLATA affiliate to market or sell the BOC's telephone exchange services and section 272(e)(4) lets the interLATA affiliate obtain intraLATA facilities and services from the BOC.

Joint marketing and selling, as authorized by these sections, is not limited in any way by the Act, and necessarily includes (without limitation) advertising both services

¹ Furthermore, the Act does not prohibit the BOC itself from providing administrative services to the separate affiliate, as the Commission allowed under *Computer II*.

² The requirements imposed by section 272 are more stringent than those currently required by the Commission under either *Computer III* or *Competitive Carrier*.

together, telemarketing (inbound and outbound), making services available from a single source, and/or offering packages and bundles of services at single or discounted prices.³

To compete successfully, the Bell company should have the same flexibility of corporate organization as its competitors and be able to take advantage of economies of scope and scale, subject only to the restrictions required in the Act. In particular, the holding company, or a services affiliate, should be able to provide shared administrative services⁴ to both the BOC and the interLATA affiliate. Nothing in section 272 applies to the holding company or restricts what it may provide to the BOC or interLATA affiliate.

The Commission's existing rules, as well as the detailed provisions of the Act, are more than adequate to assure that joint marketing and shared administrative services—which clearly are permitted under the Act—pose no risk of cross-subsidy or discrimination that would call for additional rules beyond a restatement of the Act itself. Nor is there any threat of a violation of consumer's privacy expectations from authorized joint marketing.

Discrimination

Other provision of the Act, notably section 201, 202, 251, and 252, are a bulwark preventing BOC discrimination against competing carriers. Section 272 supplements these sections with non-discrimination provisions in subsections 272(c)(1) and 272(e), which specifically prohibit the BOC from discriminating between the interLATA affiliate and other carriers.

Not all intracorporate dealings are governed by nondiscrimination requirements, nor should they be so restricted. In the first place, the provision by the holding company or another affiliate of non-telecommunication administrative services is not regulated. For example, section 272(c)(1) applies only to the BOC, not the holding company. Second, section 272(g)(3) expressly exempts joint marketing activities between the BOC and the interLATA affiliate from the nondiscrimination provisions of section 272(c).

Section 251 requires the BOC to provide nondiscriminatory interconnection, access to unbundled network elements, resale services, and collocation to competing carriers. This section, and detailed implementing regulations, make it inconceivable that

³ It would be helpful if the Commission were to define authorized marketing and selling activities. For example: "The term 'market or sell' as used in this subpart includes (without limitation) any of the following: advertising the availability of combined local exchange and interLATA services, inbound or outbound joint telemarketing of local exchange and interLATA services, making combined local exchange and interLATA services available from a single source, and/or providing bundling discounts for the purchase of combined local exchange and interLATA services."

⁴ Examples of shared administrative services include finance and accounting, legal services, human resources, marketing communications, research and development, new product development, certain procurement, management information and marketing support systems, real estate management, and business placement.

the BOC could discriminate in favor of the interLATA affiliate with respect to any service or facility of any competitive significance.

In addition, section 251(g) carries forward the equal access and nondiscriminatory interconnection restrictions and obligation applied to the BOCs by the MFJ. This assures that the provision of exchange access to interLATA carriers that compete with the interLATA affiliate will be on nondiscriminatory terms. The BOC will inform customers that they have a choice of interLATA carriers and take the customer's order for the interLATA carrier the customer selects. Thus, it will meet its equal access obligations and also be able to market and sell the services of its interLATA affiliate on inbound calls.

Section 272(c)(1) imposes nondiscrimination obligations on the BOC vis-à-vis the interLATA affiliate with respect to the provision or procurement of goods, services, facilities, and information, or in the establishment of standards during the 3-year period when structural separation is required.

In the joint marketing context, section 272(g)(1) imposes a nondiscrimination obligation on a BOC that allows its interLATA affiliate to market or sell the BOC's telephone exchange services. The BOC must offer competitors the same marketing opportunities.

Finally, section 272(e) enacts a list of specific non-discrimination obligations that survive the sunset of section 272(c)(1), including nondiscriminatory provisioning of telephone exchange service and exchange access, nondiscriminatory provision of facilities, services, or information concerning provision of exchange access, and nondiscriminatory pricing. Subsection 272(e)(4) specifically allows the BOC to provide any interLATA or intraLATA facilities or services to the interLATA affiliate if it makes the same offering to all carriers. Thus, if the BOC were to provide facilities to be used by the affiliate for either local or long distance services, all other carriers would be given the same opportunity.

Competing interexchange carriers can detect and report any discrimination they may experience. Indeed, any discrimination having a competitive impact in the marketplace would have to be obvious to customers, as well. In addition, existing reports under the Commission's CEI/ONA and ARMIS requirements give more than sufficient information about provisioning/installation and maintenance/repair for all service elements that would be relevant for section 272 purposes.⁵ Therefore, no new reports are needed.

⁵ The CEI/ONA report could be modified to show service the BOC provides to its interLATA affiliate compared to all other customers.

Reports at a greater level of detail may be appropriate as a business matter in connection with provision of service and facilities under interconnection agreements. The BOC can arrive at mutually satisfactory reporting requirements with its interconnection customers without a universal, detailed, publicly available reporting requirement imposed by the Commission.

Cross-subsidy

Section 272(b)(2) requires that the interLATA affiliate maintain books, records, and accounts that are separate from those of the BOC. Section 272(b)(5) requires the BOC and interLATA affiliate to conduct transactions on an arm's length basis. Section 272(c)(2) requires the BOC to account for all transactions with a separate affiliate in accordance with the Commission's accounting principles.

Application of the Commission's existing affiliate transaction rules⁶ will satisfy these statutory requirements and are more than sufficient to address cross-subsidy concerns. For carriers subject to price caps, the effect of cost shifting on price is largely eliminated, thus adding an additional layer of protection against any adverse effect on consumers or competition due to cost shifting. The affiliate transaction rules are intended to protect against cross subsidy from a regulated entity to its nonregulated affiliate. These rules, as now in effect, could apply to any provision or receipt by the BOC of marketing or administrative services of the interLATA affiliate. The Commission need only order that the interLATA affiliate be deemed to be nonregulated for Title II accounting purposes only.

If the BOC were to provide marketing or administrative services to the affiliate, §32.27(d) of the rules requires that the interLATA affiliate pay the established prevailing price for those services (if such a price is available) or the fully distributed cost. This satisfies the Act's arm's length requirement as well as assuring that no cross-subsidy flows between the BOC and the affiliate, because the BOC will be fully compensated.⁷

The Commission's existing record-keeping requirements satisfy the Act by ensuring that these transactions will be auditable.

The Commission's rules require each BOC to file a cost allocation manual (CAM) with the Commission. This meets the Act's requirements because the BOC must describe all transactions with the interLATA affiliate and must make the CAM publicly available.

⁶ 47 C.F.R. §§32.27, 64.902.

⁷ Minor changes to the affiliate transaction rules would be appropriate to permit rates appearing in publicly filed agreements submitted to a state commission and in statements of generally available terms (SGAT) pursuant to §252(f) to be another acceptable valuation basis and to use a uniform rate of return for affiliate transactions.

Section 272(d) requires a biennial federal/state audit of a BOC's compliance with section 272. This audit, along with the annual CAM audit required by the Commission, will give ample assurance that the accounting safeguards are being met.

In sum, the Act's requirements, as fully implemented by the Commission's existing cost allocation and affiliate transaction rules, together with price caps, assure that joint marketing or shared administrative services cannot harm consumers or competition by cross-subsidy.

Use of CPNI for joint marketing

The Commission's implementation of the privacy requirements regarding CPNI under section 222 should not preclude one-stop shopping. The BOC can market jointly the interLATA affiliate's interLATA services to those customers who have given permission for such use by whatever means are permitted as a result of CC Docket No. 96-115. The BOC may seek oral approval to use CPNI to market its affiliate's services. In addition, nothing in Section 222 limits the BOC's right to share CPNI with the interLATA affiliate if it has the customer's approval to do so. When the BOC obtains CPNI approval for such use, it is not obliged at the same time to seek such approval on behalf of other carriers, nor to share the CPNI with them. Instead, section 222(c)(2) contains specific procedures for supplying CPNI to others upon affirmative written request.

This balanced approach to use of CPNI fully protects customer's privacy expectations, while according the BOC necessary flexibility to market new services competitively.

Conclusion

Section 272 of the Act allows the BOC and its interLATA affiliate to market jointly local and long distance services. It also allows the holding company or a services affiliate to provide administrative services to the BOC and the interLATA affiliate. Section 272, along with other provisions of the Act and the Commission's existing rules, is adequate to prevent joint marketing or shared services from causing discrimination or cross-subsidy. Section 222 can be implemented consistently with customer privacy requirements and joint marketing needs. The Commission need only adopt rules mirroring the requirements of section 272, with a provision defining joint marketing, in order to protect consumers and foster competition.

APPENDIX _
AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

1. Part 64, Subpart S of Title 47 of the Code of Federal Regulations (C.F.R.) is added to read as follows:

Subpart S—Separate Affiliate; Safeguards.

§ 64.1901 Basis and purpose.

(a) Basis. These rules are issued pursuant to the Communications Act of 1934, as amended.

(b) Purpose. The purpose of these rules is to implement section 272 of the Communications Act of 1934, as amended, 47 U.S.C. 272.

§ 64.1903 Separate Affiliate Required for Competitive Activities.

(a) A Bell operating company (including any affiliate) which is a local exchange carrier that is subject to the requirements of section 251(c) of the Communications Act of 1934, as amended, 47 U.S.C. 251(c), may not provide any service described in paragraph (b) unless it provides that service through one or more affiliates that—

(1) are separate from any operating company entity that is subject to the requirements of section 251(c) of the Communications Act of 1934, as amended, 47 U.S.C. 251(c); and

(2) meet the requirements of § 64.1905.

(b) The services for which a separate affiliate is required by § 64.1903(a) are:

(1) Manufacturing activities (as defined in section 273(h) of the Communications Act of 1934, as amended, 47 U.S.C. 273(h)).

(2) Origination of interLATA telecommunications services, other than—

(i) incidental interLATA services described in paragraphs (1), (2), (3), (5), and (6) of section 271(g) of the Communications Act of 1934, as amended, 47 U.S.C. 271(g);

(ii) out-of-region services described in section 271(b)(2) of the Communications Act of 1934, as amended, 47 U.S.C. 271(b)(2); or

(iii) previously authorized activities described in section 271(f) of the Communications Act of 1934, as amended, 47 U.S.C. 271(f).